

TABLE I-1. BASELINE BUDGET PROJECTIONS  
AND UNDERLYING ECONOMIC ASSUMPTIONS

	Actual 1985	1986	1987	1988	1989	1990	1991
<b>Budget Projections (By fiscal year, in billions of dollars) <sup>a/</sup></b>							
<b>Baseline Estimates</b>							
Revenues	734	778	844	921	991	1,068	1,144
Outlays	946	986	1,025	1,086	1,135	1,188	1,248
Deficit	212	208	181	165	144	120	104
<b>Economic Assumptions (By calendar year)</b>							
Nominal GNP, percent change	5.8	6.9	7.3	7.6	7.8	7.8	7.5
Real GNP, percent change	2.3	3.2	3.1	3.3	3.5	3.5	3.2
CPI-W, percent change	3.5	3.4	4.2	4.4	4.4	4.3	4.3
Civilian Unemploy- ment Rate	7.2	6.7	6.7	6.5	6.3	6.1	6.0
Three-Month Treasury Bill Rate	7.5	6.8	6.7	6.4	6.1	5.7	5.4

SOURCE: Congressional Budget Office.

a. Includes both on-budget and off-budget outlays and revenues. See Box I-1 for elaboration.

budgetary resources sufficient to reduce 1986 outlays by more than \$11 billion. For fiscal year 1987 and beyond, CBO's baseline projections assume that funding for most programs grows only at a rate sufficient to maintain the 1986 postsequestration level of services in real terms.

These baseline projections are in sharp contrast to those of only one-half year ago. According to CBO projections prepared in August 1985, policies then being pursued would have resulted in deficits of nearly \$300 billion by 1990. The difference between the earlier projection and the current one

**BOX I-1.**  
**ON-BUDGET AND OFF-BUDGET**  
**SPENDING AND REVENUES**

Total federal outlays and revenues include both on-budget and off-budget activities. The 1985 Balanced Budget Act returned to on-budget status all previously off-budget activities--primarily lending activities carried out through the Federal Financing Bank and the purchase of oil for the Strategic Petroleum Reserve. Simultaneously, however, the act moved off-budget two Social Security trust funds--Old-Age and Survivors Insurance and Disability Insurance (OASDI). Although these trust funds are separate for accounting purposes, their outlays and revenues affect the total federal debt that must be financed by borrowing from the public and are included in calculating the deficit amount for the purposes of the Balanced Budget Act.

Section I of this volume considers both on- and off-budget outlays and revenues in describing aggregate federal fiscal activities, because both are significant for the economy and for implementation of the Balanced Budget Act. Similarly, Section II contains options that would either reduce Social Security outlays or increase revenues paid into the OASDI funds, because both sorts of options could contribute to meeting the deficit targets in the Balanced Budget Act. (The act specifies that it shall not be in order to consider any provision affecting Social Security outlays or revenues as a part of a budget reconciliation bill, but the Congress could consider such changes as a part of other legislation.) Although changes in Social Security outlays or revenues could contribute to reducing the overall federal deficit, as the following table illustrates, the Social Security trust funds themselves are currently in surplus, and that surplus is expected to grow for many years.

Baseline Budget Projections  
(In billions of dollars)

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>
Revenues						
On-budget	580	631	680	730	781	832
Off-budget (OASDI)	<u>198</u>	<u>213</u>	<u>241</u>	<u>261</u>	<u>287</u>	<u>312</u>
Total	778	844	921	991	1,068	1,144
Outlays						
On-budget	802	827	876	913	953	999
Off-budget (OASDI)	<u>184</u>	<u>198</u>	<u>210</u>	<u>222</u>	<u>235</u>	<u>249</u>
Total	986	1,025	1,086	1,135	1,188	1,248
Deficit (-) or Surplus						
On-budget	-222	-196	-195	-183	-172	-167
Off-budget (OASDI)	<u>14</u>	<u>15</u>	<u>31</u>	<u>39</u>	<u>52</u>	<u>63</u>
Total	-208	-181	-165	-144	-120	-104

is partly attributable to spending policies adopted by the Congress since then and partly attributable to changes in assumptions regarding the future (see Table I-2).

The largest changes in budget projections were in national defense. First, appropriations for 1986 fell well below the 5 percent real growth called for in the 1985 Congressional budget resolution, and the 1986 sequestration will reduce the amount of new budget authority still further. Assumptions for the out-years have changed as well. Whereas the August 1985 projections assumed continued real growth, CBO's current baseline projections assume zero real growth in defense appropriations from the 1986 postsequestration level. This change is made on the grounds that the deficit targets in the Balanced Budget Act, as an expression of Congressional policy, supersede the future defense spending levels specified in earlier budget resolutions. (In the absence of any defined future defense policy, the current CBO baseline projects the defense portion of the budget in the same manner as it projects nondefense discretionary programs, adjusting it for inflation only.) Together, these changes account for a reduction of \$96 billion in projected defense spending in 1990, relative to the level CBO projected last August.

Appropriation acts and the 1986 sequestration also reduced projected spending for appropriated nondefense programs by a total of \$22 billion in 1990, relative to the August 1985 estimate. Changes in entitlements and other spending programs--including savings through sequestration--accounted for an additional \$12 billion of the difference in the 1990 deficit projections. More than \$50 billion of the reduction in the projected 1990 deficit is accounted for by interest savings resulting from two factors--reduced borrowing needs because of the policy changes outlined above and lower interest rate assumptions than were used last August. Projected 1990 revenues declined by \$16 billion between the August forecast and the present one, partially offsetting the deficit reductions listed above.

Under CBO's current baseline assumptions, future deficits would represent a declining share of the gross national product (GNP), and the growth of the federal debt would slow appreciably. Annual deficits are projected to decline from 5.0 percent of GNP in 1986 to 1.7 percent of GNP by 1991. If this deficit path were followed, publicly held federal debt would rise from \$1.7 trillion to \$2.4 trillion. In relation to GNP, debt held by the public would increase from 41.0 percent in 1986 to a peak of 42.7 percent in 1988 and then decline to 40.2 percent by the end of 1991. <sup>2/</sup>

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2. For more detail on the budget outlook, see CBO's *The Economic and Budget Outlook: Fiscal Years 1987-1991* (February 1986).

TABLE I-2. CHANGES IN CBO BASELINE DEFICIT PROJECTIONS  
SINCE AUGUST 1985 (By fiscal year, in billions of dollars)

	1986	1987	1988	1989	1990
August 1985 Baseline Deficit	212	229	243	264	285
MAJOR CHANGES					
Lower Defense Outlays					
1986 appropriations	-4	-14	-28	-42	-56
1986 sequestration	-6	-9	-11	-11	-12
Assumed zero real growth after 1986 sequestration	- -	-3	-10	-18	-28
Subtotal	<u>-9</u>	<u>-26</u>	<u>-48</u>	<u>-71</u>	<u>-96</u>
Lower Nondefense Discretionary Spending					
1986 appropriations	-7	-14	-14	-15	-15
1986 sequestration	<u>-4</u>	<u>-5</u>	<u>-6</u>	<u>-6</u>	<u>-7</u>
Subtotal	<u>-10</u>	<u>-19</u>	<u>-20</u>	<u>-21</u>	<u>-22</u>
Changes in Other Noninterest Outlays	6	-4	-4	-8	-12
Lower Net Interests Costs					
Reduced borrowing needs as a result of policy changes	4	a/	-5	-13	-20
Lower interest rate assumptions	<u>-3</u>	<u>-8</u>	<u>-11</u>	<u>-18</u>	<u>-31</u>
Subtotal	<u>a/</u>	<u>-7</u>	<u>-16</u>	<u>-31</u>	<u>-51</u>
Lower Revenues	<u>9</u>	<u>9</u>	<u>10</u>	<u>11</u>	<u>16</u>
Total Changes	-4	-48	-78	-120	-165
February 1986 Baseline Deficit	208	181	165	144	120

SOURCE: Congressional Budget Office.

NOTE: Includes both on-budget and off-budget outlays and revenues.

a. Less than \$500 million.



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 THE CONTEXT OF BUDGET DECISIONS FOR 1987
 

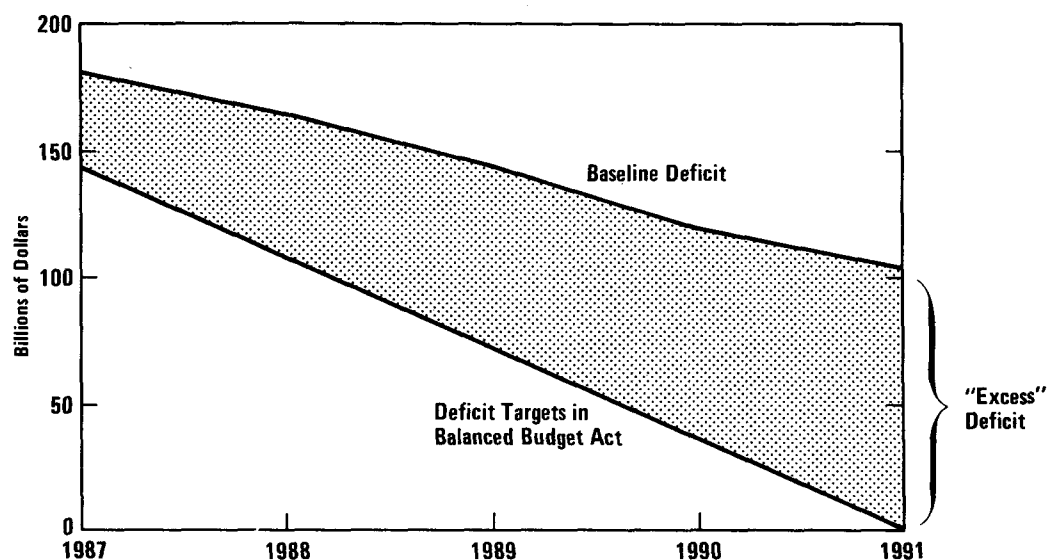
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Although the deficit picture has improved markedly in the past half year, projected budget imbalances remain large by historical standards. They also exceed the deficit targets specified in the Balanced Budget Act--by \$37 billion in 1987, and by more than \$350 billion over the 1987-1991 period (see Figure 1).

In an important sense, the Balanced Budget Act sets the terms for budget deliberations for the remainder of the decade. The act specifies maximum deficit amounts for fiscal years 1986 through 1991, leading to a balanced budget in that year. It also requires that, beginning in fiscal year 1987, the Administration's budget submissions and the Congressional budget resolutions lead to deficits equal to or less than the legislated maximums. Finally, the Balanced Budget Act specifies that if legislation that would achieve the deficit target for the year (or within \$10 billion of the target for fiscal years 1987 through 1990) has not been enacted by the beginning of each fiscal year, across-the-board spending cuts are to be made in amounts

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Figure 1.  
Baseline Deficits Compared to Targets in the Balanced Budget Act<sup>a</sup>



SOURCE: Congressional Budget Office.

<sup>a</sup> Includes both on-budget and off-budget outlays and revenues.

that would eliminate the entire "excess" deficit. (See Box I-2 for the deficit targets and timetable under the Balanced Budget Act.) 3/

On February 1, 1986, the President issued the first sequestration order under the Balanced Budget Act. The order, which has an effective date of March 1, would cancel more than \$30 billion in budgetary resources--principally budget authority, direct loan authority, and loan guarantee authority--thereby reducing federal outlays by about \$11.7 billion in 1986, with additional savings in future years. 4/ The automatic deficit reduction procedures were challenged in court, however, and on February 7, 1986, a three-judge district court panel found one aspect of those procedures to be in violation of the Constitution and declared the President's order to be "without legal force and effect." 5/ In accordance with another provision of the Balanced Budget Act, the district court stayed the effect of its own decree pending appeals to the Supreme Court. Thus, the sequestered budgetary resources remain unavailable, despite the panel's decision.

If the decision of the lower court is reversed, the sequestered budgetary resources would be canceled. On the other hand, if the Supreme Court affirms the lower court's judgment, those resources probably would become available for use, although the Court might fashion a remedy that would not void the 1986 order completely. In any event, if the Supreme Court does void the February 1 order, a fallback procedure laid out in the Balanced Budget Act could then be used to reinstate the reductions. Under that procedure, the Congress could, in effect, enact the sequestration order through a joint resolution that would become law if passed by majority vote of both Houses and signed by the President. 6/ (See Box I-3 for a description of the fallback procedure).

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3. The Balanced Budget Act also reinforces procedural barriers against consideration of individual pieces of legislation that would have the effect of breaching the deficit targets.
  4. Section 256(a)(2) of the Balanced Budget Act provides an exception in the case of amounts sequestered in special or trust funds. In these cases, the sequestered resources remain in the funds, but the Balanced Budget Act limits expenditures.
  5. Under the Balanced Budget Act, the Presidential order to sequester resources is triggered by a report to the President from the Comptroller General, who heads the General Accounting Office. The court found that because the Comptroller General can be removed by the Congress, it is constitutionally improper for him to exercise such an executive role.
  6. The cuts could also be made through a series of rescission proposals by the President, if they were approved by the Congress.

BOX I-2.  
**MAXIMUM DEFICIT AMOUNTS AND DEFICIT REDUCTION TIMETABLE  
 UNDER THE BALANCED BUDGET ACT**

**Maximum Deficit Amounts**

<u>Year</u>	<u>Maximum Deficit (In billions of dollars)</u>
1986	171.9
1987	144.0
1988	108.0
1989	72.0
1990	36.0
1991	0.0

NOTE: Sequestration in 1986 is limited to \$11.7 billion. In fiscal years 1987 through 1990, sequestration would be triggered only if the estimated deficit exceeds the maximum by more than \$10 billion.

**TIMETABLE FOR FISCAL YEAR 1986**

January 10	Policy "snapshot" of the deficit for fiscal year 1986 is taken. Laws and regulations as of this date are used for the January 15 report.
January 15	Directors of the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) report to the Comptroller General on the deficit outlook and needed spending cuts.
January 21	Comptroller General issues report to the President, based on the OMB/CBO findings.
February 1	Presidential sequestration order is issued based on the Comptroller General's report.
March 1	Sequestration order takes effect.

**TIMETABLE FOR FISCAL YEAR 1987 AND THEREAFTER**

August 15	Policy "snapshot" of the deficit is taken. Laws and regulations as of this date are used for August 20 report.
August 20	Directors of OMB and CBO report to the Comptroller General on deficit outlook and needed spending cuts.
August 25	Comptroller General issues report to the President.
September 1	If a sequestration is called for, the initial Presidential order is issued based on the Comptroller General's report.
October 1	Initial order takes effect; sequestered funds are withheld from obligation.
October 5	Directors of OMB and CBO issue revised report to reflect final Congressional action on efforts to reduce the deficit.
October 10	Comptroller General issues revised report to the President.
October 15	If a sequestration is still necessary, the final Presidential order, based on the revised report, is effective; sequestered funds are permanently canceled.

As noted, CBO's baseline budget projections assume that the reductions in 1986 funding called for under the February 1 order will eventually go into effect--either as a result of a ruling by the Supreme Court upholding the constitutionality of the automatic deficit reduction mechanism, or by subsequent legislation. By reducing the amount of budgetary resources available in 1986, those cuts--if they do go forward--will reduce outlays for many years into the future, thereby also contributing toward meeting the statutory targets for 1987 and beyond. Thus, if the Court strikes down the sequestration order, and if it is not enacted through legislation, the spending cuts or revenue increases necessary to meet the targets for 1987 through 1991 will have to be that much larger.

BOX I-3.  
**FALLBACK DEFICIT REDUCTION PROCEDURES  
UNDER THE BALANCED BUDGET ACT**

Section 274(f) of the Balanced Budget and Emergency Deficit Control Act of 1985 provides for a fallback deficit reduction mechanism if any of the reporting procedures that trigger automatic spending cuts are found to be unconstitutional.

Under the fallback procedure, the Comptroller General's involvement in the process would be eliminated. Instead, on those dates on which the Directors of the Office of Management and Budget and the Congressional Budget Office would have reported to the Comptroller General, they would report to a Temporary Joint Committee on Deficit Reduction comprising the full membership of the Senate and House Committees on the Budget. The Joint Committee would be required to report within five days a joint resolution "setting forth the contents of the report of the Directors." Presumably this resolution would have the effect of enacting through legislation the across-the-board spending reductions that would otherwise have occurred through Presidential order. Each House would then have five days after the resolution was reported to vote on it, with special rules applying that would expedite its consideration and prohibit amendments to it. As with any other joint resolution, in order to become law it would have to be passed by each House of the Congress and signed by the President, or passed by a two-thirds vote of each House in the event of a Presidential veto.

In ruling the automatic deficit reduction procedures to be unconstitutional on February 7, 1986, a district court panel found that the fallback mechanism was consistent with the Constitution.



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However the uncertainty regarding the 1986 sequestration is resolved, if by next fall the deficit for 1987 is estimated to exceed the statutory maximum of \$144 billion by more than \$10 billion, the Congress and the President will be faced with the prospect of another across-the-board spending reduction--either through executive order or through a joint resolution that would legislate the spending reductions. It is the prospect of further across-the-board cuts that drives the need to act and that distinguishes this budget cycle from any previous one.

## **CHAPTER II**

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### **ALTERNATIVE APPROACHES**

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### **TO MEETING THE DEFICIT TARGETS**

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Numerous approaches are available to the Congress for achieving the statutory deficit targets for 1987 and beyond. The choice among competing approaches involves basic judgments about the appropriate scope and role of the federal government. In short, what services should be provided, and how should those services be financed?

#### **THE STARTING POINT**

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Any discussion of how to accommodate federal spending and taxing policies to the constraints of the Balanced Budget Act logically begins with a consideration of outlays and revenues under current policies. Although the automatic deficit reduction procedures in the Balanced Budget Act would close the remaining deficit gap solely by reducing outlays, the options available to the Congress encompass both spending and revenues.

#### **The Composition of Outlays**

On the outlay side of the ledger, a large share of federal activity is concentrated in a limited number of areas (see Table II-1). Of total 1987 baseline outlays, more than one-fourth will be devoted to national defense, and more than two-fifths will be devoted to entitlements and other mandatory spending programs, the largest of which are retirement and health care programs for the elderly that do not require recipients to meet any test of need. All the remaining functions of government together (other than interest payments) account for less than one-fifth of total spending. Outlays for these purposes are referred to in this volume as nondefense discretionary spending. (See Box II-1 for definitions of spending categories.)

Relative to the economy as a whole, total federal spending under CBO's baseline assumptions would amount to 22.8 percent of GNP in 1987--down seven-tenths of a percentage point from 1986, and the lowest



TABLE II-1. CBO BASELINE OUTLAY PROJECTIONS FOR  
MAJOR SPENDING CATEGORIES (By fiscal year)

Major Category	1985	1986	Projections				
	Actual	Base	1987	1988	1989	1990	1991
<b>In Billions of Dollars</b>							
National Defense	253	269	284	296	311	327	344
Entitlements and Other							
Mandatory Spending	440	454	474	509	536	567	604
Nondefense Discretionary							
Spending	172	173	174	183	188	196	204
Net Interest	129	139	145	154	158	159	160
Offsetting Receipts	-48	-49	-51	-56	-58	-61	-64
Total	946	986	1,025	1,086	1,135	1,188	1,248
On-Budget	769	802	827	876	913	953	999
Off-Budget (OASDI) <sup>a/</sup>	177	184	198	210	222	235	249
<b>As a Percent of GNP</b>							
National Defense	6.4	6.4	6.3	6.1	6.0	5.8	5.7
Entitlements and Other							
Mandatory Spending	11.2	10.8	10.5	10.5	10.3	10.1	10.0
Nondefense Discretionary							
Spending	4.4	4.1	3.9	3.8	3.6	3.5	3.4
Net Interest	3.3	3.3	3.2	3.2	3.0	2.8	2.7
Offsetting Receipts	-1.2	-1.2	-1.1	-1.2	-1.1	-1.1	-1.1
Total	24.0	23.5	22.8	22.4	21.8	21.1	20.6
On-Budget	19.5	19.1	18.4	18.1	17.5	17.0	16.5
Off-Budget (OASDI) <sup>a/</sup>	4.5	4.4	4.4	4.3	4.3	4.2	4.1

SOURCE: Congressional Budget Office.

- a. Refers to outlays for Old-Age, Survivors, and Disability Insurance (Social Security). See Box I-1 for a description of the budgetary treatment of Social Security.

BOX II-1.  
**FEDERAL SPENDING CATEGORIES**

**National Defense.** Outlays for military and civilian personnel, operating costs, weapons procurement, research and development, and military construction.

**Entitlements and Other Mandatory Spending.** Programs in which spending is governed by a law making all who meet their requirements eligible to receive payments. Subcategories are:

**Health Care.** Includes outlays for Medicare and for the federal share of Medicaid expenditures.

**Social Security and Other Retirement and Disability Programs.** Includes old-age, survivors, and disability benefits under Social Security, as well as other federally financed retirement and disability programs, including federal civil service and military retirement and disability programs, veterans' pensions and compensation, and Supplemental Security Income. (As described in Box I-1, Social Security expenditures are now classified as off-budget.)

**Other Entitlements and Mandatory Spending.** Entitlements and other mandatory spending not included above. Major examples are: non-means-tested or partially means-tested benefits such as Unemployment Insurance, Guaranteed Student Loans, and child nutrition; means-tested benefits such as Food Stamps and Aid to Families with Dependent Children; certain state and local grants such as General Revenue Sharing and the Social Services Block Grant; and agricultural price supports.

**Nondefense Discretionary Spending.** All nondefense programs for which spending is determined by annual appropriations, or by loan or obligation limits imposed in appropriation acts. The basic governmental legislative, judicial, and tax-collecting functions are included. A large part of this category represents the salary and expense accounts that finance the ongoing operations of the civilian agencies of government. Most grants to state and local governments (other than for benefit payments) and nondefense research and development are also in this category.

**Net Interest.** Interest payments on the federal debt, less interest received by trust funds and other interest payments to the federal government.

**Offsetting Receipts.** Proprietary receipts from the public and the employer share of employee retirement. Other receipts (for example, foreign military sales, trust fund receipts, and payments to trust funds) appropriately netted against outlays are included in the relevant categories above.



share since 1981. Baseline spending for defense in 1987 would represent 6.3 percent of GNP, entitlements would account for 10.5 percent of GNP, and nondefense discretionary spending an additional 3.9 percent. By 1991 under CBO's baseline assumptions, total outlays would drop by another two percentage points to less than 21 percent of GNP, with the decline spread among all spending categories.

### The Composition of Revenues

In contrast to outlays, total federal revenues are projected to remain nearly unchanged as a share of GNP during the projection period, hovering between 18.7 percent and 19.0 percent of the gross national product (see Table II-2). The composition of revenues would, however, change somewhat, with the share paid directly by individuals rising.

Between 1987 and 1991, individual income tax collections--the largest single source of revenues--would grow from 8.5 percent of GNP to 9.0 percent, and social insurance taxes and contributions (primarily Social Security revenues) would increase from 6.7 percent to 6.9 percent of GNP. During the same period, corporate income tax collections would rise very slightly then move downward to 1.9 percent of GNP by 1991. All remaining revenue sources taken together--excise taxes, customs duties, Federal Reserve payments, estate and gift taxes, and certain miscellaneous charges and fees--are projected to decline from 1.6 percent to 1.2 percent of GNP between 1987 and 1991.

### Putting Outlays and Revenues Together

Although outlays and revenues are projected to converge under CBO's baseline projections, a gap equal to about  $1\frac{1}{2}$  percent of GNP would remain in 1991--the year in which the Balanced Budget Act requires that the deficit be zero. A deficit of this size cannot easily be eliminated by targeting any single sector of the budget. For example, focusing exclusively on defense would require a cutback of about one-fourth in that area; limiting cuts to entitlements would entail a reduction of about one-seventh below baseline levels; and relying solely on cuts in nondefense discretionary spending would require a reduction of more than one-third. Eliminating the deficit gap solely through increased revenues is also difficult. The amount needed would be roughly equivalent to a 15 percent surcharge on individual income

TABLE II-2. BASELINE REVENUE PROJECTIONS BY SOURCE (By fiscal year)

Major Category	1985	1986	Projections				
	Actual	Base	1987	1988	1989	1990	1991
In Billions of Dollars							
Individual Income	335	354	385	422	461	501	543
Corporate Income	61	72	89	100	108	112	114
Social Insurance	265	281	301	332	355	385	415
Windfall Profit	6	4	2	2	2	2	1
Other Excises	30	29	29	28	27	28	29
Estate and Gift	6	6	6	5	5	5	6
Customs Duties	12	12	14	15	16	17	18
Miscellaneous	<u>19</u>	<u>19</u>	<u>19</u>	<u>18</u>	<u>18</u>	<u>18</u>	<u>18</u>
Total	734	778	844	921	991	1,068	1,144
On-Budget	548	580	631	680	730	781	832
Off-Budget (OASDI) <u>a/</u>	186	198	213	241	261	287	312
As a Percent of GNP							
Individual Income	8.5	8.5	8.5	8.7	8.8	8.9	9.0
Corporate Income	1.6	1.7	2.0	2.1	2.1	2.0	1.9
Social Insurance	6.7	6.7	6.7	6.9	6.8	6.9	6.9
Windfall Profit	0.2	0.1	<u>b/</u>	<u>b/</u>	<u>b/</u>	<u>b/</u>	<u>b/</u>
Other Excises	0.8	0.7	0.6	0.6	0.5	0.5	0.5
Estate and Gift	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Customs Duties	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Miscellaneous	<u>0.5</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>
Total	18.6	18.6	18.7	19.0	19.0	19.0	18.9
On-Budget	13.9	13.8	14.0	14.1	14.0	13.9	13.8
Off-Budget (OASDI) <u>a/</u>	4.7	4.7	4.7	5.0	5.0	5.1	5.2

SOURCE: Congressional Budget Office.

a. Refers to federal revenues paid into the Old-Age, Survivors, and Disability Insurance trust funds to finance Social Security benefits. See Box I-1 for a description of the budgetary treatment of Social Security.

b. Less than 0.05 percent.

taxes, or an increase of more than 70 percent in corporate tax revenues. <sup>1/</sup>  
As a result, most budget plans attempt to gain ground on several fronts.

### ALTERNATIVE DEFICIT REDUCTION APPROACHES

The Congress could adopt any mix of spending reductions and revenue increases to close the gap between CBO's baseline projections and the maximum deficits called for in the Balanced Budget Act. Alternatively, the Congress could choose what might be considered the "default" option of allowing a series of sequestrations to take place under provisions of the Balanced Budget Act.

Choosing among alternatives entails making judgments about what the scope and role of government ought to be. The Administration's budget proposal, for example, reflects a number of such judgments--that the level of resources devoted to defense should increase; that states and localities should assume a greater responsibility for certain functions now financed in part by the federal government; and that the provision of some other services should be left to the private sector. Even the option of relying on spending reductions under the Balanced Budget Act represents a set of judgments couched in rules governing what programs shall be cut and by how much.

The following describes the "default" option, the Administration's 1987 budget submission, and examples of alternative approaches.

#### Sequestration Under the Balanced Budget Act

If the Congress fails to act before the beginning of the next fiscal year to reduce deficits from projected baseline levels, it will be faced with the prospect of triggering a second sequestration to achieve the 1987 deficit target. Under guidelines specified in the Balanced Budget Act, several

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1. The size of needed deficit reductions relative to current policies include only savings required through program cutbacks or revenue increases. Some of the deficit gap would be closed by interest savings that would arise automatically because of lower federal borrowing needs resulting from the policy-related savings. (See discussion later in this chapter.)

spending categories would be exempt from cuts. These include interest payments on the federal debt, Social Security benefits, state unemployment benefits, and several low-income assistance programs. Together these categories account for nearly 40 percent of all federal outlays. Another 14 percent of all outlays would be partially protected. These include indexed federal retirement and disability programs, for which the reduction would be limited to forgoing the annual cost-of-living adjustment; and Medicare, and several smaller health care programs, each of which would be subject to no more than a 2 percent cut. The remainder of the budget--new budgetary resources for defense and nondefense discretionary programs--would be subject to across-the-board cuts sufficient to eliminate the excess deficit. Overall, one-half the savings would come from cutbacks in defense, and one-half from reductions in nondefense programs.

The size of any across-the-board reduction for fiscal year 1987 is impossible to forecast at this time for two reasons. First, it will depend on the economic outlook as it will appear next fall. Second, the base for the cuts will not be known until then. The Balanced Budget Act specifies that the reductions in appropriated programs are to be taken from funding levels included in full-year appropriations, if they have been enacted by the time a sequestration is triggered. If a full-year appropriation (or a full-year continuing resolution) has not been enacted for a program, the size of the cut for that program is to be calculated from the funding level of the previous year.

While the size of any 1987 sequestration cannot be known now, illustrative calculations can be made.<sup>2/</sup> For example, if CBO's current economic forecast remains unchanged, if no changes in tax policies or in entitlements are adopted between now and next October, and if no full-year appropriations are enacted by then, across-the-board reductions of 6.2 percent in budgetary resources devoted to defense and 8.4 percent in nonexempt domestic programs would be required to achieve the 1987 deficit targets. These cuts would be taken from funding levels that would have already been reduced by between 4 percent and 5 percent from their 1986 appropriations, as a result of that year's sequestration. The cumulative effect would therefore be to reduce budgetary resources devoted to defense by 10.8 percent between the 1986 appropriation level and 1987, and to cut resources provided for nondefense discretionary programs by 12.3 percent over the same period. The reduction in real terms would be even greater

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2. For a description of how the spending reductions would be calculated, see Chapter III of CBO's *The Economic and Budget Outlook: Fiscal Years 1987-1991* (February 1986).



because of the erosion in the buying power of the funds. Moreover, even after a second sequestration, further across-the-board cuts may be required to satisfy the deficit targets for 1988 and beyond.

As this example illustrates, while relying on sequestration might reduce budgetary resources in total increments that appear small in any particular year, the effect of the cutbacks could be substantial. If the Congress were to rely solely on sequestration to achieve all future deficit targets, then by 1991 total federal outlays would equal just under 19 percent of GNP, the lowest share since 1966. Also, the composition of outlays would change, with entitlements growing as a share of total spending, and outlays for appropriated defense and nondefense programs making up smaller shares of the total.

#### The Administration's Proposal

In its 1987 budget submission, the Administration has proposed a quite different path toward realizing the statutory deficit targets.<sup>3/</sup> Like sequestration, the Administration proposals would rely almost entirely on spending cuts. Unlike sequestration, however, the Administration would concentrate all reductions on nondefense spending. In fact, resources devoted to defense would grow by 6 percent in real terms between the 1986 postsequestration level and 1987, and by an average of about 3 percent per year in real terms between 1986 and 1991.

On the domestic side of the budget, cutbacks would be concentrated on discretionary programs, but would include substantial constraints on growth in some entitlements. Proposed cuts in appropriated programs include sizable reductions in housing, transportation, community and economic development, education, and environmental assistance. Savings in entitlement programs would be achieved primarily by eliminating General Revenue Sharing and by limiting growth in Medicare, Medicaid, and federal employee retirement and health care programs. The Administration is also proposing to raise receipts to the government through increased premiums charged for participants in the Supplementary Medical Insurance component of Medicare; fees charged for such services as navigation assistance, and customs and meat inspections; and the sale of five power marketing administrations and the Naval Petroleum Reserves.

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3. For more detail on the Administration's plan, see CBO's *An Analysis of the President's Budgetary Proposals for Fiscal Year 1987* (February 1986).

The Administration estimates that its proposed policies would satisfy the Balanced Budget Act deficit targets. But under CBO's economic and technical assumptions, the Administration's plan would result in deficits that exceed the targets by about \$16 billion in 1987 and by \$40 billion in 1991 (see Table II-3). As reestimated by CBO, outlays in 1991 under the Administration's proposals would amount to 19.7 percent of GNP, and a deficit equivalent to 0.7 percent of GNP would remain.

TABLE II-3. OUTLAYS AND REVENUES UNDER THE  
ADMINISTRATION'S 1987 BUDGETARY PROPOSALS  
AND AS REESTIMATED BY CBO  
(By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991
<b>Administration's Budgetary Proposals</b>					
As estimated by the Administration					
Outlays	994	1,027	1,064	1,094	1,123
Revenues	<u>850</u>	<u>933</u>	<u>996</u>	<u>1,058</u>	<u>1,124</u>
Deficit (-) or Surplus	-144	-94	-68	-36	1
As reestimated by CBO					
Outlays	1,010	1,060	1,091	1,141	1,190
Revenues	<u>850</u>	<u>928</u>	<u>1,000</u>	<u>1,075</u>	<u>1,150</u>
Deficit (-) or Surplus	-160	-132	-91	-67	-40
<b>Maximum Deficit (-) Under the Balanced Budget Act</b>					
	-144	-108	-72	-36	0

SOURCE: Congressional Budget Office; Office of Management and Budget.

NOTE: Includes on-budget and off-budget outlays and revenues.



While the Administration's budget as reestimated by CBO would fall short of the Balanced Budget Act targets, it would greatly alter federal priorities. For example, annual outlays for national defense would rise by \$33 billion by 1991, or about one-half percent of GNP, relative to CBO's baseline projections. Outlays for entitlements and other mandatory spending programs would fall by an amount roughly equal to the increase in defense. Spending for nondefense discretionary programs would be cut by \$40 billion by 1991, or one-fifth below CBO's baseline projection.

### Other Approaches

A virtually limitless number of options are available to the Congress in fashioning an alternative to either sequestration or the Administration's proposal. The Congress could alter the mix of spending cuts, place part of the burden on revenues, or do both.

Whatever the mix of spending and taxing changes, the Congress can construct deficit reduction plans either on the basis of general rules of thumb regarding the treatment to be afforded to different classes of programs, or by making program-by-program assessments. The sequestration procedure laid out in the Balanced Budget Act is, of course, an example of a set of general rules very broadly applied. The attraction of such an approach is that it greatly simplifies the enormous complexity of dealing individually with the more than 1,000 spending accounts. The risk is that some activities might be given unintendedly harsh or lenient treatment as a result of being included in some general category of federal activities.

Although the alternative of making all decisions on a program-by-program basis allows separate assessments of the relative value of different activities, it requires many more individual judgments and may be more difficult to coordinate legislatively. Most budget plans, therefore, involve some combination of the two approaches. They make specific judgments about some of the largest or most highly valued programs, while applying rules of thumb to others--for example, freezing appropriations for certain programs at their base-year levels, allowing others to grow only enough to keep up with inflation, and permitting still other programs to increase at some specified rate in excess of inflation. (See Box II-2 for a discussion of issues in defining a budget "freeze"--one commonly proposed formula approach to deficit reduction.)